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INTRODUCTION

In accordance with the City Auditor's 1990-91 Audit Workplan, we have reviewed City-wide contracts relating to sole source and standardization purchases. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

BACKGROUND

The San José City Charter and the Municipal Code specify the contract authority and contracting requirements and procedures within the City government. Implicit in the Charter and the Code are the purchasing goals of competition, fairness, economy, and openness. To achieve these goals, the Code requires competitive bidding as the primary method for City procurement. However, there are circumstances when competitive purchases are not appropriate. Recognizing such circumstances, the Municipal Code prescribes alternate methods of purchasing. This audit report focuses on the City's risks and controls relating to two procurement methods that are exceptions to the City's bidding requirements: sole source and standardization purchases.

SCOPE AND METHODOLOGY

This audit report is the second of two reports on the City's sole source and standardization purchases. The first report covered sole source and standardization purchases that were for more than \$5,000 but not more than \$20,000. This report concerns sole source and standardization purchases that were for more than \$20,000. During Fiscal Year 1988-89, these purchases totaled approximately \$4.7 million. We tested the documentation of these purchases to determine if they were adequately justified. In addition, we reviewed Purchasing Division's research activities in making sure that these purchases were available only from sole source or standardization vendors.

FINDING I

THE CITY NEEDS TO IMPROVE THE DOCUMENTATION OF SOLE SOURCE AND STANDARDIZATION PURCHASES

Sole source and standardization purchases are intended to expedite the City's acquisition process by eliminating the need to subject purchases to a competitive bid process. Because sole source and standardization purchases, by definition, expose the City to certain inherent risks, the City's Municipal Code prescribes under what circumstances sole source and standardization purchases should be used. Further, authoritative purchasing standards require that:

- Sole source and standardization purchases should be justified in writing; and
- Price negotiations with sole source and standardization vendors should be documented.

Our review did not disclose any evidence of inappropriate transactions involving sole source and standardization purchases. Our review, however, revealed that the City did not adhere to the above documentation standards for 37 of the 53 sole source and standardization purchases over \$20,000 that the City made during 1988-89. These 37 sole source and standardization purchases totaled \$3,595,681. As a result, the City is exposed to the risk of: 1) stifling competition, 2) favoring certain vendors, and 3) paying more than the lowest possible price for sole source and standardization purchases over \$20,000.

Sole Source And Standardization Purchases

The San José Municipal Code (Code) and authoritative purchasing standards prescribe under what circumstances sole source and standardization purchases should be used.

The Code requires competitive bidding as the City's primary procurement method. However, it does allow sole source procurement by listing it as one of the conditions under which the City's bidding requirement does not apply. Section 4.12.020 states in part,

"Purchases of supplies, materials and equipment shall be in accordance with bidding requirements provided in the city Charter and in this chapter. Bidding requirements shall not apply in any of the following: ... D. The purchase of any supplies, materials or equipment which can be obtained from only one vendor or manufacturer."

The Code also allows standardization purchases, but only under specified circumstances. Section 4.12.149 states:

"Where the director of general services has determined that it is required by the health, safety or welfare of the people or employees of the city or that significant costs savings have been demonstrated, standardization of supplies, materials or equipment is permitted and the specifications may limit the purchase to a single brand or trade name. Among the factors that may be considered in determining to standardize on a single brand or trade name are that: (A) Repair and maintenance costs would be minimized; (B) User personnel training would be facilitated thereby; (C) Supplies or spare parts would be minimized; (D) Modifications to existing equipment would not be necessary; (E) Training of repair and maintenance personnel would be minimized; (F) Matching existing supplies, materials or equipment is required for proper operation of a function or program."

The Model Procurement Code - Recommended Regulations (MPC) of the Section of Urban, State and Local Government Law recommends the following as conditions for the use of sole source procurement:

"Sole source procurement is not permissible unless a requirement is available from only a single supplier. A requirement for a particular proprietary item does not justify a sole source procurement if there is more than one potential bidder or offeror (SIC) for that item. The

following are examples of circumstances which could necessitate sole source procurement:

- (a) where the compatibility of equipment, accessories, or replacement parts is the paramount consideration;*
- (b) where a sole supplier's item is needed for trial use or testing;*
- (c) where a sole supplier's item is to be procured for resale;*
- (d) where public utility services are to be procured.*

The determination as to whether a procurement shall be made as a sole source shall be made by the Chief Procurement Officer, the head of a Purchasing Agency, or designee of such officer. Such determination and the basis therefor shall be in writing. Such officer may specify the application of such determination and the duration of its effectiveness. In cases of reasonable doubt, competition should be solicited. Any request by a Using Agency that a procurement be restricted to one potential contractor shall be accompanied by an explanation as to why no other will be suitable or acceptable to meet the need. (Emphasis added) (MPC-Recommended Regulations, page 49)."

The National Association of State Purchasing Officials, State and Local Government Purchasing, also has the following comments and recommendations regarding standardization purchases:

"The brand name specification (i.e., standardization) or a detailed specification which is written to have the effect of limiting the bidding to a single product are the most restrictive kinds of specifications. Their use should not be permitted unless only one product will meet an intended need, and the chief purchasing official has made a prior written determination to this effect. And even where product competition has to be denied, price competition should be solicited to the extent possible. (Emphasis added) (SLGP, page 44.)."

From the foregoing, it is clear that the San José Municipal Code and authoritative purchasing standards recognize sole source and standardization purchases as legitimate and useful purchasing methods. However, authoritative purchasing standards caution purchasing officials regarding the inherent risks for those purchases and emphasize the need to justify such purchases in writing.

37 Of 53 Sole Source And Standardization Purchases Over \$20,000 Were Not Adequately Documented

During 1988-89, the City made 53 sole source and standardization purchases over \$20,000. We reviewed each of these purchases to determine if such purchases were adequately justified. Our test revealed that 37 of the 53 purchases did not include sufficient written justification for the method of purchase selected. These 37 sole source and standardization purchases totaled \$3,595,681. It should be noted, however, that our review did not disclose any evidence of inappropriate transactions involving any of the 53 sole source and standardization purchases over \$20,000.

APPENDIX B describes the justification, research, and documentation for each of the 53 sole source and standardization purchases that the City made during 1988-89. APPENDIX C summarizes our review of the documentation for each of the 37 sole source and standardization purchases over \$20,000 that we found to be inadequately documented.

In general, we found one or more of the following deficiencies in the documentation for each of the 37 sole source and standardization purchases:

- Documentation for the research for other possible sources was not on file at Purchasing, although the research may have been performed by the department requesting the purchase.
- Documentation for the price quotation or bids was missing.
- Documentation for the testing to substantiate standardization on the product was not on file at Purchasing.
- Purchase order and purchase requisition were missing.
- Documentation of contacts with other vendors was not on file.
- Purchasing staff failed to verify statements of the requesting department regarding the need for sole source purchase.

- Documentation of contacts with other government agencies to confirm sole source information was not on file.
- Purchasing staff failed to update the justifications for standardization on the product.
- Documentation of information to demonstrate compliance with Municipal Code standardization criteria was not on file.
- Purchasing failed to identify sole source and standardization purchases in the memorandum to the City Council requesting approval of open purchase orders.

CONCLUSION

Authoritative purchasing standards require that:

- Sole source and standardization purchases should be justified in writing; and
- Price negotiations with sole source and standardization vendors should be documented.

Our review did not disclose any evidence of inappropriate transactions involving sole source and standardization purchases. Our review, however, revealed that the City did not adhere to the above documentation standards for 37 of the 53 sole source and standardization purchases over \$20,000 that the City made during 1988-89. The City paid \$3,595,681 for the 37 sole source and standardization purchases that were not adequately documented or supported.

As a result, the City is exposed to the risk of: 1) stifling competition, 2) favoring certain vendors, and 3) paying more than the lowest possible price for sole source and standardization purchases over \$20,000.

RECOMMENDATIONS

We recommend that the General Services Department:

Recommendation #1:

Require that written justification of sole source purchases clearly substantiate that the supplies, materials, equipment, or services to be purchased can be obtained from only one vendor or manufacturer. (Priority 2)

Recommendation #2:

Require that written justification of standardization purchases clearly substantiate that the reasons for the standardization of purchases are current. (Priority 2)

Recommendation #3:

Require that any justification for standardization indicate the duration of its effectiveness. (Priority 2)

Recommendation #4:

Require that appropriate General Service staff review, approve, and file with the purchase documents at Purchasing those documents that support or justify sole source and standardization purchases, including documentation of price negotiations with vendors. (Priority 2)

Recommendation #5:

Require that sole source and standardization purchases be identified in the memorandum to the City Council requesting approval of open purchase orders. (Priority 2)

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